



OXFORD ANALYTICA

INDONESIA

FISCAL TRANSPARENCY

Country Report 2006

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5 Alfred Street
Oxford OX1 4EH

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INDONESIA



COMPLIANCE RATINGS

<i>Fiscal transparency</i>	2006	2005	2004	2003
Clarity of roles
Availability of information
Budget preparation
Accountability
Score	3.25	3.25	3.00	2.50

OUTLOOK & COMMENTARY

In December 2005, a cabinet reshuffle intended to improve economic management led to the appointment of new ministers for Finance, Planning and Economic Affairs. The IMF Report on Observance of Standards and Codes (ROSC) assessment in mid-2006 received high level support from the Ministry of Finance. The results of the ROSC have been widely discussed in government agencies, signalling the new Finance Minister's commitment to fiscal transparency.

There was a significant improvement in the level of auditing transparency in Indonesia during 2006, with the new State Audit Law passed in October. The Supreme Audit Commission plans to approach the Constitutional Court to allow it full authority to audit the Tax Office.

In other areas, there is gradual progress. Despite successive regulations and amendments to laws, ambiguities remain in the roles and responsibilities of different levels of government. A revised draft package of five tax bills that became mired in controversy last year is now expected to be passed early in 2007.

Indonesia subscribes to IMF SDDS and complies with its standards for central government data, but sub-national reporting is inadequate and subject to delays. The government is receiving technical assistance for this, and improvements in data reporting can be expected in the coming years. At present, Indonesia maintains modified accrual standards and is working toward implementation of full accrual-based accounting.

EXECUTIVE SUMMARY

3.25 Enacted

Indonesia continued to make progress with fiscal transparency in a number of areas, most notably in auditing. A cabinet reshuffle in December 2005 brought in a new Finance Minister, Planning Minister, and Coordinating Minister for Economic Affairs in an effort to improve economic management and enhance coordination in policy making and implementation. The IMF Report on Observance of Standards and Codes (ROSC) assessment in mid-2006 received high-level support from the Ministry of Finance. The ROSC was also produced in Bahasa Indonesia and has undergone extensive follow-up in terms of publicising it in government agencies.

While a third of central government revenues are transferred to the regions, expenditure assignments between central and local governments are still unclear. A draft law on regional taxation has been prepared by the Ministry of Finance and is currently being reviewed by the legislature. Efforts are ongoing to improve data reporting of sub-national governments, which in some cases are reporting data with a two-year lag.

There has been a significant improvement in the level of auditing transparency. On 30 October 2006, the new State Audit Law was passed (Law No. 15/2006), significantly increasing the powers of the State Audit Agency (BPK). Nevertheless, it still does not have a clear remit to audit the Tax Office (through which nearly three-quarters of government revenue flows) and the BPK intends to approach the Constitutional Court for a ruling that would enable it to do so.

The Tax Office has itself undergone changes during 2006 with the appointment of a new head, and a modernisation drive is underway. However, a draft tax package which was intended to broaden the tax base and improve tax administration foundered on complaints that it put excessive power in the hands of the tax collector. A revised package is expected to be passed by early 2007.

The government is moving to a medium-term expenditure framework (MTEF) from an annual basis, initiating economic planning over a three-year period. The planned date for implementing this is 2008. In addition, the task of identifying accounts outside treasury control began in 2006. The plan is to place all government bank accounts under treasury oversight and to complete the consolidation of all government cash balances into the Treasury Single Account (TSA) by mid-2007. This will assist in budget monitoring.

The government intends to move to full accrual accounting by 2008 but this is unlikely given significant capacity constraints. At present, Indonesia maintains modified accrual standards. The government also plans to submit a law on public sector procurement to the legislature, replacing Presidential Decree No. 18/2000. The draft law prescribes penalties for corruption in the procurement process.

Indonesia's overall score is unchanged from last year.

1. CLARITY OF ROLES, RESPONSIBILITIES, AND OBJECTIVES



Enacted

The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.

Structure, functions and responsibilities of government

Indonesia's form of government is based on the 1945 Constitution as amended, which specifies that the state is structured as a unitary republic.¹ The constitution establishes the division of government between the executive branch, the legislative branch and the judiciary. Responsibilities of the President, the People's Consultative Assembly (MPR), the State Audit Agency (BPK), the Supreme Court, the Constitutional Court, and the Judicial Commission are explained in government websites.² The MPR is entirely elected and consists of two chambers, the House of Representatives (DPR) and the Regional Representatives' Council (DPD).

Fiscal relationships between the government and legislature are defined in the State Finance Law No. 17/2003. The DPD has no powers over legislation or the budget. Because most government policies are supported by legal regulations, confusion has arisen due to conflicts in laws promulgated by different agencies.³

The division of responsibilities between the central government, the 33 provinces (each headed by a governor), and local governments was fundamentally changed by legislation passed in 1999.⁴ From the beginning, a major concern in the decentralisation process was to increase clarity in the roles and responsibilities of the various levels of government.

In October 2004, a new Regional Autonomy Law No. 32/2004 and a Revenue Sharing Law No. 33/2004 were announced. These laws brought about some improvements by addressing the relationship between the central government and local administrations. However, the Regional Autonomy Law did not sufficiently address the problem of clearly assigning responsibilities within sectors. While over a third of central revenues now accrue to regional governments, central government departments continue to carry out expenditure in areas that had been devolved to the regions in 1999. According to the World Bank, "it is still not clear who is in charge of key public services, and central government departments continue to spend more than 50% of their development budgets in the regions on infrastructure services that are the responsibility of provinces and *kabupaten/kota*".⁵

The Ministry of Finance (MoF) and the Ministry of Home Affairs (MoHA) have faced overlaps in terms of authority in setting rules for fiscal management, with a number of implementing regulations being contradictory. The lack of harmonisation between the MoHA and the MoF was largely resolved in 2005 through the establishment of a joint task force to draft legislative amendments.⁶ Despite these efforts, there remains ambiguity in the roles and responsibilities of different levels of government, and there is weak coordination between central and regional governments. Regulations that clearly delineate expenditure responsibilities have not been issued.⁷ Financial accountability and reporting by central and local governments is established in the Audit of State Financial Accountability and Management Law No. 15/2004 and Government Regulation No. 24/2005 on the Government Accounting Standard.

Under Law No. 33/2004, every August the Minister of Finance establishes limits on regional government loans. Nevertheless, there are no effective sanctions for non-compliant provincial governments.⁸ Previously, if the central government failed to approve regulations proposed by local governments within a given time, these automatically became law but this no longer the case.⁹ The amendments to the decentralisation laws have meant the adoption of a 26% target (by 2008) for the transfer of net domestic revenues to regional and local governments, and have also reduced the scope for mismatches of revenue and expenditure assignments.¹⁰

Coordination and management of budgetary activities

Law No. 17/2003 on State Finances gives clear responsibility to the MoF for fiscal policy, the macro-economic framework, and preparation of the annual budget. However, another law relating to national development planning, Law No. 25/2004, also gives Bappenas responsibility for drawing up macro-economic plans. According to the MoF, there is no ambiguity of responsibilities between the two agencies, which coordinate their plans and jointly evaluate the budget.

Bappenas prepares the preliminary draft of the annual government work plan (RKP), which establishes policy priority areas. Parallel to this, the MoF develops fiscal policy and, together with the National Development Planning Agency (Bappenas), produces indicative ceilings for each ministry. Bappenas evaluates the discretionary expenditure component (capital expenditures and transfers) while the MoF is responsible for discussions on non-discretionary expenditure (personnel, subsidies of fertiliser, fuel, electricity and transport) with the line ministries. Based on the priority plans and indicative ceilings, line ministries submit their plans to Bappenas and the minister of finance. Bappenas evaluates the appropriate priority programme in terms of its consistency with the five-year Medium Term Development Plan (MTDP) while the MoF focuses on the cost efficiency of the programmes.¹¹

Each year the executive prepares the budget estimates for presentation to the DPR. The president, with the assistance of the minister of finance and Bappenas, is responsible for the final preparation of the estimates prior to legislative approval. The budget is passed in agreement between the president and the DPR once the legislature has examined fiscal policy, the macroeconomic framework, and the budget.¹²

There is now a clearer framework covering regional borrowing. In 2004, there was a ban on all regional borrowing. With the latest amendments in 2005, regional governments may only borrow onshore funds that originate from the central government, other regional governments, banks, non-bank financial institutions and the public. Onshore borrowings from the public must be in the form of domestic bonds, which a regional government may issue upon approval from its regional legislature and the central government. Regional governments may also undertake certain offshore borrowing (two-step loans) through the MoF after obtaining approval from MoHA.¹³

The government is implementing a comprehensive budget-reporting framework, whereby regions will have to report twice a year on budget realisation. Regarding budget coordination, central and local governments must undertake the synchronisation of planning and budgeting based on the National Development and Planning System Law No. 25/2005. According to commentators, further progress is needed in the standardisation of accounting systems, and fiscal management capabilities in the regions need to be enhanced as these can vary widely. Some regional governments are still using their own standards, but in June 2005 the BPK released accounting standards for all levels of government; these should be rolled out to local governments in the near term. In addition, all levels of government should now start compiling data in agreement with a classification that broadly follows the IMF Government Financial Statistics Manual 2001 (GFSM 2001).

Relations between government and public sector agencies

Government relations with the central bank -- Bank Indonesia (BI) -- are governed by the Central Bank Act (CBA, Law No. 23/1999) and amendments to the CBA as established by BI Law No. 3/2004, which give the central bank legal independence. The law prohibits BI from providing credit to the government. The CBA clearly establishes the responsibilities of BI and proscribes government interference in the conduct of monetary policy. The only overlap in the government's operations and those of the central bank occurs in the issuance of bonds and the holding of government deposits.

Legislative changes went into effect in 2003 that affect the government's relations with state-owned enterprises (SOEs). According to the SOE Law No. 19/2003 the state is not allowed to become involved in the day-to-day management of SOEs and must allow them full operational autonomy. The same law also sets out rules regarding employees. SOE employees are not part of the civil service, so that remuneration and employment decisions cannot be made by the government.¹⁴ In 2002, the DPR passed a new law that places SOEs under higher levels of supervision. The law simplifies the corporate structure of SOEs, clarifies the economic requirements for privatisation and restructuring, and requires that each SOE have at least three different internal supervisory agencies. In the past, commentators have argued that proper enforcement of the State Enterprises Law No. 19/2003 would make it harder for political parties and government officials to use SOEs as "cash cows" for political or personal gain.¹⁵ In May 2005, the president issued Presidential Decree No. 8/2005 on the appointment of boards for state-owned enterprises (SOEs). The new decree regulates the selection process of SOE executives based on merit, skill, professionalism, and integrity, as well as the transparency and accountability of the process.

Article 71 of the State Enterprises Law states that audit of SOEs financial statements will be undertaken by external private auditors (public accountants) appointed by the Ministry for State Enterprises. In practice, this would remove state-owned enterprises from financial audits by the BPK, and commentators feel that this will reduce the transparency of the financial management of SOEs.¹⁶ In the oil and gas sector, with the state-owned Pertamina established as a limited liability company since 2003, its accounts for 2004 and 2005 were audited by *Ernst and Young*. According to the IMF, it intends to schedule a corporate bond issue which would subject it to the scrutiny of rating agencies, thereby improving transparency.¹⁷ As of 2006, 24 SOEs out of the total of some 150 still have not had their 2004 financial accounts audited.¹⁸

The sale of SOEs to private investors has been an important in promoting private investment and improving their efficiency, transparency, public accountability and corporate governance. Since 1997, 17 SOEs have been privatised in part or in full but recently the privatisation programme has stalled.¹⁹ No SOEs were privatised in either 2005 or 2006, nor during the first nine months of 2006 – despite the fact that the government target for proceeds from privatisation for the year is 3 trillion Indonesian rupiah.

There are a number of agencies that carry out public service obligations (PSOs) – for instance, provision of electricity, water supply and infrastructure in poor areas. The state also regulates prices in many sectors, especially in the energy and transport industries. Some of these are explicitly subsidised and accounted for in the budget. But in a number of cases, subsidies fall short of full costs that are borne by the enterprise in question, constituting a quasi-fiscal activity. This in turn can raise fiscal risks. Reportedly, the Ministry of State-Owned Enterprises is developing a standardised approach to treat these obligations.²⁰

Government involvement in the private sector

Until recently, the Indonesian government formed a considerable presence in the private sector, mostly as a result of the bank rescue during the 1997-98 financial crisis during which the government recapitalised the banking sector and thereby acquired bank assets worth 43 billion US dollars. Under a plan agreed in 2004, the outstanding emergency loans extended under BI's emergency bank liquidity programme will be replaced by government securities.²¹

The government also has private sector holdings through private charitable/non-profit organisations, commonly known as ‘foundations’ or *yayasan*. These entities, which have had the status of legal entities since 2001, use government assets and raise funds from the public, and are controlled by government institutions and line ministries at the central and regional levels. A report from Human Rights Watch in 2006 suggests that the number of businesses controlled by the Indonesian Armed Forces (TNI) and the Indonesian National Police (POLRI) through an opaque network of *yayasan* may now exceed 1,500.²² Attempts have also been made to audit the TNI’s business interests, but these enterprises, which may generate as much as 70% of the military’s expenditures, remain off budget. The Armed Forces Law No. 34/2004 enacted in September 2004 states that all off-budget businesses from the armed forces must be transferred to the government within five years. Commentators judged that this process has been slow, and in general the accountability of *yayasan* remains weak because the government’s implementing regulations relating to the Foundations Law have still to be drafted.²³

There should be a clear legal and administrative framework for fiscal management

Legal framework for budgetary activities

The State Treasury Law No. 1/2004 and the State Finance Law No. 17/2003 have significantly strengthened the legal framework for budgetary activities. Nevertheless, the IMF noted in 2005 that “the proliferation of extra budgetary funds, weak cash and debt management, and shortcomings in the decentralisation framework continue to hamper fiscal management.”²⁴

Several elements of the legal framework have been clarified. The law provides a comprehensive definition of “state finance” and outlines the general terms for the management of state finances. Also, the legislation clearly states that the president holds full authority for the management of state finances, a role that may be delegated to the minister of finance, other ministers/chairmen of institutions, and governors, regents, and heads of local governments. In addition, the law stipulates a clear division of roles -- at both the national and regional level -- in the processes of budget drafting, deliberation, approval, implementation, and accountability. It also provides for performance-based budgeting.

The State Treasury Law, in turn, provides rulings on how state funds, assets and debts should be managed by government officials both at the central and local levels. There is also a new functional budget classification system that seeks to unify the development and recurrent budgets.

Legal framework for taxation

The rules and procedures governing central government tax administration are set out in two different laws: one on tax administration and the other on arrears collection.²⁵ Recent initiatives designed to assist taxpayers and increase tax revenues include simplified VAT audits, refunds for taxpayers who file accurate returns and various reforms designed to improve the quality of taxpayer services, including improving access to information and adopting a taxpayer bill of rights and a tax officer code of ethics. To improve tax collection, the government has gradually introduced measures to ensure that all persons and corporations with income levels above the non-taxable income level have taxpayer identification numbers. Notices have been sent to potential taxpayers to encourage registration; if recipients do not register, they could be subject to higher tax rates than those applicable to registered taxpayers. There are now 10 million taxpayers, but most of them have not yet submitted tax returns, so at this stage is difficult to assess the extent to which the tax base has expanded through these efforts.²⁶ However, despite this apparent progress, even the new Director General of Taxation admits that tax collection will fall short of the target set for 2006. Total receipts by November 2006 were 300.3 trillion Indonesian rupiah, only 81% of the full year target.

Traditionally, Indonesia's tax offices have been organised by the type of tax. In June 2002, the first Large Taxpayers Office (LTO) opened in Jakarta under the purview of the Directorate General for Taxation (DG Tax) in the MoF. The office focuses on processing the tax statements of the largest taxpayers and aims to provide open, transparent, and accountable services to large taxpayers. Significantly, under this system one person is responsible for all taxes from a given company or individual. This system is expanding, by registering more taxpayers and opening new LTOs in a number of regions. A Medium Taxpayers Office (MTO) and a Small Taxpayers Office (STO) started operations in Jakarta as of mid-2005. To reduce the likelihood of corruption, this new tax system thoroughly screens officials and offers relatively high salaries. Except for some STOs, transactions will be fully computerised such that taxpayers can do most of the work online. The STO operates both online and manual systems, owing to the inability of some taxpayers to use online facilities.²⁷ New IT systems are being developed for the DG Tax to enhance efficiency and transparency and it is hoped that by 2007 there will be a dedicated Data Processing Centre.²⁸

Tax collection remains inefficient, especially when compared with tax systems in neighbouring countries. According to Transparency International-Indonesia, the tax department is perceived as the most corrupt institution within the public service.²⁹ A charter of taxpayers' rights has been established to set out legal obligations and rights of taxpayers and a complaints centre has been established at the DG Tax headquarters to report misconduct by tax officials. There are two routes for tax complaints: the Office of Inspector General and the independent National Ombudsman Commission. Concern remains over the suitability of the current arrangements, because the Inspector General is internal to the MoF, while the Ombudsman has no power to sanction tax officials and can only issue recommendations to DG Tax. Additionally, the Tax Tribunal holds court hearings in public and is placed under the supervision of the State Administrative Court (PTUN). Decisions issued by the tribunal are final and binding. A code of ethics for tax collectors has been produced, and a special division within the MoF's Office of Inspector General (Investigations Unit) has been set up which can recommend criminal investigations and/or sanctions to the MoF.

A package of five bills to reform the tax system is under scrutiny in the DPR; it includes three tax laws, on income tax, value-added tax (VAT) and luxury tax, and tax administration. The goal is to make the taxation system more business friendly, and to broaden the tax base in the medium term. The revised laws introduce a simpler tax rate structure and improved tax administration – in particular, for VAT refunds. A number of commentators pointed to concerns within the business community that the three tax law drafts need significant revisions, as they have several inadequacies and fail to address the imbalance between tax auditors' powers and taxpayer rights. The package has been mired in controversy from the outset, with one of the main concerns being that the draft laws put excessive powers in the hands of the tax collector. The business community has concerns related to access to taxpayer bank information, authority to seize or block bank accounts, the power to arrest and detain a person, and the requirement of full settlement of a tax obligation before completion of the appeals process. A revised draft is now being circulated among the relevant agencies, including the Tax Office. Commentators suggested that the law would be passed by early 2007.³⁰

In April 2006, the government dismissed the chief of the Tax Office in response to allegations of graft and a new head was appointed. One of the reforms planned in order to limit the authority of tax officials is a separation between the function of collecting taxes and that of making regulations. The blueprint for reform also includes a reduction in the number of employees.³¹

A special law is being drafted on public tax consultants in order to reduce collusion between tax consultants and the tax office (40% of tax consultants giving advice to taxpayers were former (retired) tax officials who file tax returns for their clients).³²

Local tax and levies are regulated by Regional Taxes and Levies Law No. 34/2000 and Government Regulation No. 65/2001 and No. 66/2001. The levy of regional taxes, duties, fees, and charges has been complicated by Indonesia's

decentralisation process. Law No. 34/2000 authorises local governments to create new taxes, fees, and levies subject only to undefined principles. The decentralisation programme has increased the importance of shared revenues. The most important factor was the inclusion of oil and gas revenues and personal income tax in the taxes to be shared. For each of the shared taxes, the province receives a minor part, whereas the bulk of the revenues go to local governments.

Law No. 34/2000 authorised local governments to create their own taxation instruments, but the law did not allow local governments to apply taxes to the same tax bases as the central government. The draft revision of law Law No. 34/2000 intends to introduce a closed list of taxes and user fees that can be imposed locally. The draft law on regional taxation has been prepared by the Fiscal Policy Unit in the MoF and is now with the Directorate General of Fiscal Balance which is working on an improvement of some articles and items in the law. It is anticipated that the draft will be submitted to DPR in 2007.³³

Ethical standards for public servants

There is no single code of ethics covering the entire civil service. Ethical standards for public servants are explicitly stated in the laws of major governmental institutions, including BI and the LTO. A Code of Conduct, with its corresponding Code of Conduct Committee, has been established within the Office of the National Ombudsman. Lack of enforcement and monitoring remain a serious concern. The World Bank has been assisting with financing for a governance programme to help Indonesia with the structural progress needed to reduce corruption and restore integrity in the public sector. The Yudhoyono administration has made governance a priority but there remain concern about the structural nature of corruption and measures needed to tackle it.

The government has gone ahead with plans to integrate the functions of the Independent Commission for the Audit of the Wealth of State Officials (KPKPN) into an anti-corruption commission in a manner that preserves the integrity of the wealth declaration process. As mandated by Law No. 30/2002, the Corruption Eradication Commission (KPK), established in December 2003, set up a special anti-corruption court that started operations in 2004. The wealth reports, however, are no longer made available to the public owing to legal technicalities that could potentially expose the KPK to prosecution. To prevent abuse of its extraordinary powers, KPK has adopted two codes of ethics – one for its commissioners and another for its staff.

The State Finance Law has also strengthened the standards for public servants. In particular, Article 35 makes government officials personally responsible for state funds under their control. If properly enforced, officials will face jail terms for embezzlement and mismanagement, and they will be forced to personally reimburse the state for any misused or embezzled public money. All civil servants are subject to equal punishment for the same fiscal crime, regardless of rank.

2. PUBLIC AVAILABILITY OF INFORMATION

... Enacted

The public should be provided with full information on the past, current, and projected fiscal activity of government.

The single budget for routine and development expenditures, which was initiated in 2005 to achieve one of the main goals budgetary reorganisation within the MoF, was maintained in 2006. The 2003 *Report of the Conversion Guidance Team for Changes in Format of the State Budget* explains in detail the changes to the format of the state budget, where expenditures are now classified according to core administrative functions and public service activities.³⁴

Central government operations

Data on central government operations cover all budgetary central governments units, including ministries, departments and non-ministerial institutions. The operations of the extra budgetary units of central government are not included. The annual *Semester Report on the State Budget* (Laporan Realisasi APBN Semester I) publishes data for the first six months of the current fiscal year, showing revenue and expenditure details of budgetary central government.³⁵ That document is published in the seventh month of the current fiscal year. The annual *Supplementary Budget Report* (Laporan APBN-Perubahan) publishes annual provisional data for expenditure realisations of the current fiscal year, and it is published at the end of the fiscal year. A brief review of the performance of the current year's budget is available on BI's Investor Information and Enquiries (IIE) website.³⁶ Summary information on the budget for the following year, including macroeconomic assumptions and future government policies affecting government revenues, is also publicly available.

Transparency in financial management has benefited from the State Finance Law, which covers all state funds in all state institutions. It requires the government to submit reports no later than July on budget implementation for the first half of the current year. In addition, to ensure accountability, the president must deliver a speech on the status of the state budget's implementation, audited by the BPK, six months after the current fiscal year ends. Similarly, governors, mayors and regents must deliver accountability speeches at local legislatures six months after the current fiscal year ends.

There are no systematic and publicly available reports on the government's contingent liabilities, tax expenditures or quasi-fiscal activities.³⁷ A significant obstacle to fiscal transparency in Indonesia is the opacity of off-budget accounts -- mostly non-tax revenues collected by government and government-linked institutions that, in general, are not publicly reported. Some efforts have been made over the past three years to make these funds more transparent and to bring them into the budget process. In its audit report published in September 2005, the BPK identified over 1,000 off-budget accounts held by numerous government ministries and institutions. As such, it is unclear how much progress has been achieved despite commitments to bring them on budget. The fact that so many off-budget accounts are now being audited and are open to greater scrutiny should increase pressure on the institutions involved to bring them on budget. However, uncertainty remains about the total number of off-budget funds that various ministries and state agencies retain. In addition, although the Foundations Law and the State Audit Law limit the legal authority of the BPK to audit *yayasan*, the BPK seems prepared to conduct audits whenever it is deemed necessary.³⁸

The programme of performance audits of SOEs has now largely been concluded and the question now is what should be the follow-up. The audits of key SOEs (Garuda, Pelindo II, Jasa Marga, Telkom, PT PN-IV) were completed in 2002, the results published, and corrective actions formulated. These audits, conducted by the State Development Audit Agency (BKPK) have been criticised by the State Audit Agency (BPK) for inattention to possible financial irregularities in the SOEs' financial reports.³⁹ The State Finance Law contains several positive measures to improve the transparency of the SOE sector. Under the law, the BPK will audit all SOEs, including those under the central government and those under regional administrations. All SOEs operating under the central government are required to attach their financial reports to the government's budget accountability report, which must be submitted to the DPR by the president. SOEs operating under regional governments must attach their financial reports to the local government's budget accountability report, which will then be tabled at the local legislature.

Public sector operations

Data are disseminated on general government operations, and cover the operations of the budgetary central government, the provincial and local governments. Data on social security funds and extra-budgetary funds are not included. Data breakdown includes revenue; expenditure; the deficit/surplus; and financing, broken down by currency into foreign-currency financing, and domestic-currency financing. The data for central government and the provincial governments are based on the accounting records of actual outturns for all levels of government (not all local governments are included). The annual *Financial Report and State Budget* (Nota Keuangan dan RAPBN), published ten months after the end of the reference year, publishes annual consolidated data for the various elements of general government on revenue; expenditure, the deficit/surplus; and financing, broken down into foreign-currency financing, and domestic-currency financing.

With the implementation of fiscal decentralisation, the quality of sub-national government fiscal data has become a central concern for effective and transparent fiscal management. Currently, the central government requires the regions to submit financial reports to the MoF that include their budget, budget implementation reports, and final accounts. The MoF is working to improve its Regional Financial Information System (SIKD) to allow for online submission. The MoF then publishes summary financial data on its website.⁴⁰

Progress in establishing an effective reporting system for regional finances has been slow. One key problem is that the central government has hitherto used a Government Finance Statistics Manual (GFSM) 1986-compliant system, while local governments compiled data on a non-standardised basis. In 2005, the central government started a process to switch to GFSM 2001, and has drafted regulations on Local Government Financial Management such that budget classification and accounting rules follow the provisions established by Government Regulation No. 24/2005 on the Government Accounting Standard.

Under Decree No. 29/2002 on Local Government Budgets, the fiscal performance of local governments should be evaluated based on procurement standard examinations, work performance indicators, and cost standards. Performance budgeting has gradually been introduced; it is expected that performance indicators will increase transparency and accountability in regional fiscal planning in the medium term. However, it will be some time before regional governments are familiar with them.⁴¹

A commitment should be made to the timely publication of fiscal information.

Indonesia subscribes to the IMF Special Data Dissemination Standard (SDDS) and complies with the standards for coverage, periodicity, and timeliness of reporting central government and public sector data.⁴² As of 2006, an executive summary of the budget is published on a monthly basis. On a quarterly basis, the MoF publishes a summary plus a breakdown of revenue, expenditure and financing. Consolidated GFSM 2001 figures are released annually which consist of general government finance (which includes the central government budget and extra-

budgetary activities) as well as consolidated provincial and local government finance. The report is released in a timely manner on the SDDS website. The quality of central government data is good and reported with a one month lag but local and provincial government data is below standard. Although coverage is 80-90% and is increasing, in some outlying areas the time lag can be as much as two years. Most regions however report within nine months and the government is using sanctions against regions that are not complying. Some regions are submitting daily accounting reports.⁴³

Preliminary, unaudited data for the previous year are published at the end of January and may be revised two or three times. These revisions take place over a six month period, and the audited report for the previous year is available in July. Given the introduction of the GFSM 2001 classification and the new regulations on the Government Accounting Standard, it is expected that a long transition period will be required to achieve full implementation. Indonesia has taken a flexibility option for the timeliness of SDDS data on general government operations.⁴⁴ The MoF has received technical assistance from the IMF to improve fiscal transparency with an emphasis on statistical dissemination. The MoF is keen to improve the mechanism and systems of data reporting. There is no date for moving to an online system of reporting.⁴⁵

Debt reporting

Information on government debt and financial assets is published with the annual budget. Financial assets are also reported by the central bank, and information on government debt, including loans, interest, debt outstanding, maturity dates, and closing dates is covered in the government annual budget report. Projected repayments of short-term debt are published periodically. The MoF began publishing a consolidated balance sheet for the previous fiscal year in 2005.⁴⁶ BI publishes information on its debt management on behalf of the government, particularly on external debt. This information is available in Bahasa Indonesia and English on BI's website.⁴⁷ Data on government-guaranteed debt and SOE debt are not made available to the public.

Advance release calendars

The Indonesian government publishes an advance release calendar giving three month's notice of the expected release dates of public sector data. The same applies to data from central government operations and for central government debt. In all three cases, notification of the exact release dates is given one week in advance and disseminated via the IMF's Dissemination Standards Bulletin Board.

3. OPEN BUDGET PREPARATION, EXECUTION, AND REPORTING

●●●● Compliance in progress

Fiscal policy objectives, macroeconomic framework, and risks

Fiscal policy objectives

The Yudhoyono administration has introduced two new documents: the National Medium Term Development Plan 2004-2009 (RPJMN, Presidential Regulation No. 7/2005) and the annual Government Work Plan (RKP, Rencana Kerja Pemerintah). The RPJMN provides medium-term goals for the socio-economic development of Indonesia, with decentralisation and regional autonomy as priority areas.⁴⁸ The RPJMN sets six policy goals: clarify the division of authority between the levels of governance; encourage interregional cooperation in the context of enhancing public services; arrange the institutions of regional governments to make them more proportional and professional in accordance with their needs; prepare a regional government apparatus that is qualified based upon standards of competence; increase the financial capacity of the regional government; and arrange new autonomous regions.

The RKP is an annual plan for the implementation of development objectives, and serves as a guideline for the formulation of the State Budget Bill (APBN) by including specific measures and targets that aim to fulfil the RPJMN's mission.⁴⁹ The government presents the APBN for the next fiscal year along with its Financial Note Document. The APBN is compiled based on each year's RKP -- which is also presented to the Budget Committee of the DPR for discussion.

The State Finance Law and Government Regulation No. 23/2003 prescribes the fiscal rule that the consolidated national and local government budget deficits be limited to 3% of GDP in any given year, and that total central and local government debt not exceed 60% of GDP. Nevertheless, because of delayed reporting by sub-national governments it is difficult to enforce this rule. The IMF notes that debt ceilings for sub-national governments have not been established.⁵⁰

The government is moving to a three year rolling medium-term expenditure framework (MTEF) from an annual basis but implementation is not planned until 2008.⁵¹

Macroeconomic framework

The macroeconomic assumptions underlying the budget are assessed in meetings between the National Development Planning Agency (Bappenas), the MoF, and the BI. The budget mentions some of these assumptions explicitly, including economic growth, foreign exchange, interest, and inflation rates, the oil price, and crude oil production.⁵² Using these and other assumptions, a base case scenario is created and published with the budget documentation.

The World Bank had previously noted that macroeconomic models are not transparent to the public. In addition, commentators pointed out that since there is no binding agreement between the legislature and the government on fiscal policy prior to the detailed budget, discussions on macroeconomic assumptions continue throughout the budget formulation process, with the legislature sometimes changing revenue estimates.⁵³

Oil revenue projects are clearly reliant on oil price assumptions that are believed to have been conservatively estimated in the past. However, the government is now using futures prices which are likely to be more reliant and transparent.

Fiscal risks

The macroeconomic assumptions used in preparing the budget are stress-tested for changes in variables. These fiscal risks are presented to the legislature as working papers, but according to MoF officials, they are not extensively discussed.⁵⁴ According to the IMF, the budget documents submitted to the DPR do not include an analysis of the sensitivity of the estimates to changes in economic variables and the main fiscal risks are not reported.⁵⁵

Important sources of fiscal risk are the significant off-budget accounts and contingent liabilities the Indonesian government has accumulated since the 1997-98 crisis. Contingent liabilities stem primarily from those guarantees to protect depositors and creditors in the banking system, guarantee schemes to the private sector to restore the flow of credit, sovereign guarantees to private infrastructure providers, and pension payments obligations.

To a very small extent, fiscal risks are provided for in the budget in the form of a contingency fund. For instance, 6 trillion Indonesian rupiah were provided in fiscal year 2000 to anticipate a mismatch in the first round of decentralisation. Every year, an annual levy decided by consultation between the president and the DPR provides for a mismatch between ex ante and ex post policy measures. For 2006, the contingency fund was 2 trillion Indonesian rupiah or 0.1% of GDP which, according to commentators, is not sufficient to provide for fiscal risks. The 2007 budget has set aside 4 trillion Indonesian rupiah for the contingency fund.⁵⁶

In July 2003, the DPR finally approved an agreement between the government and the BI to settle accounts arising from the emergency loans extended by the central bank during the financial crisis in January 1998. In addition, the Indonesia Deposit Insurance Corporation, which started operations in September 2005, has replaced the blanket guarantee system with a regular deposit insurance scheme administered by the deposit insurance agency. The central bank's lender of last resort facility is now only made available to address systemic problems and on the basis of constructive ambiguity.

The MoF has evaluated the contingent liability of each SOE. The MoF has two fiscal risk units. One is under the Directorate General Debt Management (which handles management of risks), and there is also a Fiscal Policy Agency which focuses on policy issues. DG Budget also has a section that calculates data with both fiscal risk units. This is then incorporated in the budget. The MoF may receive technical assistance for the calculation of fiscal risks.⁵⁷

In addition, state banks have a non-performing loan (NPL) ratio of 15.9% and represent a fiscal risk. In October 2006, an important revision was made to government regulation No. 14/2005 on Selling State Assets. This accomplishes a key financial sector reform sought by the current minister of finance to empower state-owned banks to restructure their NPLs based on commercial considerations, rather than adhering to burdensome state auction procedures. Due to this change, state-owned banks are now able to dispose of their NPLs in the same manner as private banks, removing a major constraint in their ability to clean up their books. All state-owned banks will be audited by the BPK in future.⁵⁸

Fiscal sustainability

BI has recently published a series of documents on fiscal sustainability in which it discusses the government's fiscal sustainability targets, bond issuance, and measures to keep the debt burden under control. These documents are available on the central bank's Investor Information and Enquiries (IIE) website.⁵⁹ The State Budget Performance and the Government Debt Management reports elaborate on the actual realisations of quarterly revenues,

expenditures and the historical evolution of debt repayments. A Debt Strategy document was published in 2005, which presents the general strategy on managing government debt for 2006-09. Quantitative exercises on fiscal sustainability are not publicly available, although the State Budget Performance reports have sometimes covered them in qualitative terms. For example, the government has released information on the contingent liabilities that may arise as part of the new deposit insurance scheme, the liquidity facility to cover any shortfall in servicing liabilities to a restructured electricity generation project, and the guarantees to the state-owned airline in respect of a convertible bond and a standby letter of credit.

In view of the significant fiscal cost of maintaining fuel subsidies in 2004 and 2005, the government has provided information on the costs involved and changes to the way the subsidies are assigned. It is estimated that in 2005 fuel subsidies exceeded the health and education budgets. As a result, a fuel price compensation programme has been implemented through a change from commodity-based subsidies to direct cash subsidies for about 19.2 million low-income households (about 30% of all households in Indonesia). The subsidies commenced in October 2005, with the provision of cash aid until December 2006. The programme will almost certainly be extended into 2007 following monitoring and evaluation to enhance its operation and improve targeting. In the longer term, the government expects the direct cash subsidy programme to be developed into conditional cash transfers.⁶⁰

The government debt to GDP ratio improved from 97% in 1999 to just over 40% of GDP in 2006. Under the medium-term fiscal framework, this is expected to decline to 30% of GDP by 2010.⁶¹ The new unit in the MoF for managing fiscal risks is expected to assist in debt sustainability analysis.

Budget presentation

Data reporting

Law No. 17/2003 has already led to changes in the presentation of the budget, which has been made more compatible with international practice. From 2005, the previous distinction between the routine and the development budget has been replaced by a more economically meaningful classification of budgetary expenditures.

Data classification for revenues, expenditures, financing and debt will gradually be moved to a standard that is broadly compatible with GFS 2001. Budgetary funds are presented by sector, sub-sector, programme, and project/activity. Expenditure is also classified by expenditure type. This classification contains a relatively large amount (around 6% of total expenditures) for unallocated expenditures, which reduces transparency.⁶² Objectives of major government programmes are included in the budget and are presented by sector. Statements of objectives are described in more detail in a supplementary budget document called *Unit 3A*. The budget also details the central government's overall balance. In addition, the State Development Audit Agency (BPKP) regularly audits government agencies with a view to identifying any additional non-consolidated funds.

At the beginning of 2006, the central government had only received 90% of sub-national governments' budget outturns for fiscal year 2004, a lag of more than 12 months. The government of Indonesia declared in the March 2003 Letter of Intent to the IMF that developing an effective regional budget reporting system remains a priority. There is to be a strict budget-reporting framework, whereby regions will have to report twice a year on budget realisation. To ensure timely data submission, sanctions such as the postponement of transfers will be imposed on regions that fail to comply with the reporting requirements.⁶³

The budget discloses information on tax exemptions and tax estimates in terms of net value, but statements on quasi-fiscal activities are not included. Contingent liabilities are not reported in the budget document, but some of these liabilities can be found separately in relevant documents such as the balance sheet of the national electricity utility (PLN). Commentators noted that contingent liabilities will be better accounted for in the 2007 budget. Reportedly,

comfort letters and guarantees are being offered in order to stimulate public private partnerships in the infrastructure sector, and the previously unallocated contingency fund in the budget will now apply to these guarantees.

Budget execution and monitoring

The restructuring of the MoF involved, inter alia, the rationalisation of budget preparation and execution functions. Nevertheless, some of the tasks were not completed well. The Directorate General of Budget (DG Budget) moved from a traditional budgeting system to a performance based budgeting system. Changing the mindset of staff in the MoF and line ministries was not easy and required a substantial number of training and workshops. The end result fell short of what was intended. In most years, Indonesia spends 50% of its capital expenditures in the last quarter of the year but 2005 saw 54% of capital spending carried out in December alone. The budget had to be revised twice in response to complaints from line ministries. In 2006, however, expenditure is improving and as of end-October 2006 expenditure realisation was around 47.5% of the target.⁶⁴

The decentralisation laws No. 22/1999 and No. 25/1999 introduced the concept of performance budgeting for the regions. The performance-based budgets should, in theory, increase transparency and accountability in regional fiscal planning. However, it will require some time before regional governments are familiar with them. The annual accountability report of the head of the region to the district level assemblies (DPRD II) provides some useful information regarding budget monitoring. However, this document is not comprehensive in general for evaluating budget implementation and results achieved.

The State Budget Performance reports include quarterly information on total expenditure realisations in value and as a percentage of the funds in each budget, broken down into central government expenditures and transfers to regions. Realised central government expenditures are further broken down into subsidies, personnel expenditures, interest payments, material expenditures, social expenditures, capital expenditures and others.⁶⁵ The government also presents current realisations of the budget to the cabinet every month. These data are not publicly available and are intended for government offices only.

The MoF is drafting regulations on spending by regional governments that aim to set minimum service standards, by defining criteria and processes. The MoF can instruct the regional government to follow the budget for certain sectors and activities. This spending tends to be administrative rather than capital spending and is managed at the provincial level, with governments required to give an accountability report to the centre.⁶⁶

In 2005, the routine and development expenditures were combined into a single account, where expenditures are now classified according to core administrative functions and public service activities. This change has resolved serious concerns about the lack of unified oversight or control over budget preparation, and the risk of duplication of recurrent spending and diversion of budgetary resources to unintended purposes. On the other hand, the substantial off-budget funding still reduces the scope for public scrutiny. Budget allocations had typically been based on an implicit assumption that departments would raise their own funds off budget, something that was pervasive in the case of the military and police.⁶⁷

Until recently, the consolidated financial statements presented to the legislature were not available until two years after the end of the fiscal year. The government has been trying to reduce this time to no more than twelve months, with the ultimate goal of reaching the OECD standard of six months. Importantly, the MoF has now established a 'Treasury Single Account' (TSA), which has allowed Indonesia to consolidate its government accounts to compile a fiscal year 2004 balance sheet, cash flow statement, and a budget realisation report for the first time -- an important milestone for transparency in public finances and a boost for measures to combat corruption.⁶⁸ The World Bank is assisting in this regard. Already, pilot accounts with zero balance accounts exist in some locations in Jakarta. From 1 September 2006, pilot accounts have been extended to another fifty locations.⁶⁹

Accounting basis

In 2005, the BPK and the central government drafted Government Regulation No. 24/2005 on the Government Accounting Standard.⁷⁰ Previously, a number of financial accounting standards coexisted. This led the government to establish in 2002 the Government Accounting Standards Committee to overhaul the government's accounting system, to synchronise central and local government accounting and to ensure that they converge with international standards of accounting issued by the International Federation of Accountants (IFAC).

At present, Indonesia maintains modified accrual accounting standards. The government intends to introduce full accrual accounting by 2008 but commentators noted that this is unlikely given the capacity constraints and the relatively poor skills of ministries and line agencies.⁷¹ Among the main factors limiting full implementation of the new standards are extra-budgetary activities and quasi-fiscal activities.

Work on accounting reform and implementation remains a concern at the local government level. Some sub-national governments have applied these standards, and others are expected to follow in the next few years. As stipulated in Law No. 25/1999, the heads of Indonesia's districts and municipalities are responsible for public sector accounting, and local governments have so far had the freedom to develop their own systems and procedures for financial reporting. Some commentators have suggested that at present many local governments remain unprepared for adopting the Government Accounting Standard and the GFS 2001 classification, and further international assistance is needed to develop technical expertise and fund IT facilities.⁷²

Procurement and employment

The State Treasury Law provides officials at both central and local levels with detailed rules governing their management of state funds, assets, and debts. The government has to seek legislative approval for the sale of state assets, which it must conduct by tender. This is designed to reduce the opportunities for opaque asset transfers to politically connected individuals. The legislation also details penalties and sanctions for violations by state treasurers and contains clear stipulations on the settlement of government financial losses caused by mismanagement or corruption.⁷³

A revised Presidential Decree on Procurement No. 80/2003 was issued in November 2003, which tightened procedures for procurement in the public sector at both central and local government levels. This decree encompassed the establishment of a National Procurement Office (NPO), which has still not been fully operationalised. A skeleton office has been set up in Bappenas but it needs to be made independent of existing ministries.⁷⁴ The new body will be charged with policy-making in the area of procurement, disbursement settlement, and human resource reforms.⁷⁵ In addition, the National Electronic Procurement Government of Indonesia (NePGI), still in the pilot stage, is an e-Procurement application system designed for government procurement of goods and services, in order to help government agencies run a more transparent and efficient procurement process.

The government plans to submit to the legislature a law replacing Presidential Decree No. 18/2000 on public sector procurement, prescribing penalties for corruption in the procurement process. In addition, the draft law will allow companies to bid for government contracts without having to be accredited by the Indonesian Chamber of Commerce (Kadin) or its affiliated associations. Medium-sized and large-scale enterprises would be forbidden from bidding for projects reserved for small businesses (projects worth less than 50 billion Indonesian rupiah).⁷⁶ The law is still being prepared.⁷⁷

Regulations for employment practices exist and cover the recruitment process, pension plans and career plans. The organisation of the civil service system is established in Law No. 8/1974 and revised in Law No. 43/1999. Decentralisation Law No. 32/2004 assigns responsibilities for overall management of the regional civil service to

provincial governors. There are a large number of agencies at the central level which are responsible for management of the civil service, including the National Civil Service Agency (BKN), the Ministry of Home Affairs (MoHA), MOF, and the National Institute of Administration (LAN).

At present, in addition to the base salaries, there are a range of discretionary allowances and payments which render the remuneration system non-transparent. The Minister of Finance has set up a task force to examine the entire compensation package. This is intended to lead to an independent remuneration commission that would cover senior officials in the first instance and eventually the civil service as a whole. The legal framework for the civil service, which includes the basic Civil Service law of 1999, the Law on Government Organisation and the Law on Pensions, is being reviewed and revised.⁷⁸

The World Bank has been discussing issues related to civil service reform in the last few months with the Ministry for State Administration, as well as arranging pilot studies. In some ministries the World Bank is supporting various types of redundancy packages.⁷⁹

Fiscal reporting

Government authorities make regular reports on the implementation of the central government's fiscal programme, both to the legislature and the public. The annual *Supplementary Budget Report* publishes annual provisional data for expenditure realisations of the current fiscal year, and it is published at the end of the fiscal year. Monthly financial accounting reports are published internally. Reporting of sub-national fiscal activities is only presented to the regional parliaments. The MoF has set up a web-based regional financial information database with extensive budgetary information for each region, but according to some commentators little analysis is carried out on these data.⁸⁰

According to the constitution, the DPR plays a key role in budget reporting. The DPR Budgetary Commission oversees the revision statement of the approved budget by mid-year to assess the feasibility of budget implementation in light of any changes in the macroeconomic assumptions. In addition, it receives copies of the *Supplementary Budget Report* and the BPK's audited final accounts for review. The DPR's primary role, however, has traditionally been in budget formulation, with little formal provision for oversight by budgetary committees. As such, the role of the parliament as the institution with public responsibility for financial oversight is not widely understood in the country.

Data from the budgetary sector of sub-national governments are not yet reported or consolidated for general government reporting in a comprehensive or timely way.

4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY



Enacted

Data quality standards

Fiscal data are compiled and disseminated under the terms and conditions of the State Budget Law, the Supplementary State Budget Law, and Law on the Audited State Budget. The classification codes used to convert the accounting records to the revenue and expenditure categories used in the data on central government operations are published in *Codes for Expenditure* (MAK) and *Codes for Revenue* (MAP) Circular No. SE-36/A/2003.

Inadequate coordination of budget monitoring and record-keeping has resulted in duplication and fragmented financial information systems. The regions are expected to implement budget management and accountability in compliance with performance-based budgeting and government accounting standards as established by the Audit of State Financial Management and Accountability Law No. 15/2004. Data quality is expected to improve gradually over the medium term as the new Government Accounting Standard is rolled out to regional governments.⁸¹

Public activities are assessed through ad hoc sectoral and regular programme reviews. The annual *Semester Report on the State Budget* publishes data for the first six months of the current fiscal year, showing revenue and expenditure details by economic classification. The annual *Supplementary Budget Report* publishes annual provisional data for expenditure realisations of the current fiscal year.

Independent scrutiny of fiscal information

Independent macroeconomic projections are prepared by independent economic institutes, universities and international agencies, and discussions are held with them. No systematic mechanism exists, however, for external scrutiny of the government's budgetary projections by such institutions.⁸²

Independent Audit

The State Audit Agency (BPK, *Badan Pemeriksa Keuangan*) is Indonesia's supreme auditing institution, which with the passage of the Audit Law No. 15/2006 in October 2006 achieved close to full independence from the government. The BPK is funded from resources of the annual budget. This financial independence has allowed the BPK to increase its staff from 2,851 in 2004 to 3,463 in 2006, and increase the number of sub-offices from seven to 16, while modernising its equipment and increasing the basic salary of staff by a factor of nine (bringing salaries into line with those of the BPKP and the MoF). The law stipulates that BPK should eventually have an office in each of the 33 provinces – it currently has offices in just under half.⁸³

The past year has seen a significant improvement in the level of auditing transparency in Indonesia with the deeper implementation of the new laws on State Finance/Treasury/Audit. Reporting in 2005 included non-tax revenues that had never been reported before and a list of 958 individual named accounts used by ministries. About 2.5 trillion Indonesian rupiah in state funds were transferred from these accounts into the MoF Treasury account. Since then, about 600 of these accounts have been closed. The BPK estimates that all individual accounts should be gone within two years.

During the Suharto years, the BPK had a very narrow mandate, which has been significantly widened with the passing of Law No. 15/2006. Nevertheless, there continue to be ambiguities regarding key sectors which need to be audited, most notably DG Tax. These confusions result from a particular feature of lawmaking in Indonesia where very general laws are issued with the details inserted later on. In addition, old and existing laws are not nullified, creating further ambiguity. As far as DG Tax is concerned, old laws protected the confidentiality of tax information and according to the BPK it still does not have a mandate to audit DG Tax. This means that the BPK can audit only 30% of state revenues (including customs, land and building tax), leaving the other 70% unaudited. According to the BPK, it cannot give an unqualified opinion on the budget until it can audit DG Tax. The BPK plans to approach the Constitutional Court over this issue. Another interpretation of the law is that the MoF can allow the BPK to audit the DG Tax. It appears that some laws will need to be amended to rectify the situation.⁸⁴

The BPK's mission is to examine the accountability of state finances and to disclose these findings to the DPR. The BPK audits have the following objectives: to assess the fairness of the revenue budget and the reporting of actual tax revenues; to ascertain the existence of sound administration that complies with laws and regulations; and to assess the application of tax returns and penalties. As such, the BPK is not responsible for the monitoring of budget implementation; this is the responsibility of the executive. In charge of auditing all state finances, the BPK also audits SOEs and firms owned by regional governments. Special audits are performed for activities suspected to be fraudulent or criminal, and cases of abuse and misuse are noted and passed onto the Attorney General's Office (AGO) and the KPK for further action. Although the onus is on these latter institutions to pursue criminal investigations, some commentators noted that these have become much more effective since the formation of the Coordinating Team for Combating Corruption (Timastipikor) in April 2005. Timastipikor has pooled the resources of the BPK, the police, the AGO, the Centre for Financial Transaction Analysis and Reporting (PPATK) and others to investigate criminal activities.⁸⁵ The BPK now has much closer relations with police, the KPK (Anti-Corruption Commission) and the PPATK.⁸⁶

The *State Budget Financial Accounting Report* sets out the BPK's findings and is submitted to the DPR for parliamentary review.⁸⁷ There is still ambiguity on whether the Foundations Law No. 16/2001 (as amended) allows the BPK to audit, or review internal audits, of important *yayasan* controlled by, for instance, the TNI, the police and BI. Article 52 of the Foundations Law stipulates that foundations receiving (financial and other) aid from the state must be audited by public accountants. However, Article 3 paragraph 2 of the State Audit Law 15/2004 states that "in case law audits (of government and government related bodies and agencies) are undertaken by public accountants, their audit reports shall be submitted to the BPK and be made public". According to the BPK, it will now begin to audit TNI *yayasan*, just as it has already started to audit *yayasan* operated by BI. It is already starting to audit procurement at the Ministry of Defence.⁸⁸

Although the BPK is the national auditing body, the State Development Audit Agency (BPKP) -- the internal audit agency created by presidential decree during the Suharto administration -- also carries out audits on internal controls and reports directly to the president. The State Audit Law envisaged the absorption of the BPKP by the BPK, but this has not yet taken place. The line between external and internal audit is blurred, and with it, the responsibilities of the BPK and BPKP. The BPKP's status as a government agency has raised concerns over its independence in auditing public finances, SOEs, and foreign-funded projects. Some commentators judged there has been no real progress in clarifying the role of the BPKP and its relationship with the BPK. There is still no mechanism for cooperation or contact between the two agencies. The BPK has largely remained understaffed and under-resourced, while the BPKP employs highly qualified auditors that are not efficiently utilised. Several plans have been put forward to improve cooperation. For example, BPKP auditors could be gradually transferred to work as internal auditors in the various line ministries, or the BPK could use the findings reported in BPKP audits to produce synergy, minimise its own need for information, and reduce overlaps. Overall, however, such cooperation appears to pose political problems.⁸⁹

Commentators noted that the BPKP, as an internal audit agency, is a tool of management and it should have a role as an internal controller, not an auditor. According to commentators, the BPKP is now redundant.⁹⁰

With regard to internal auditing, each ministry and institution has an Inspector General who carries out internal audit functions. All transactions and financial records are audited before the accounts are sent to the MoF's Inspector General, who produces the annual financial statements. In carrying out the audit, each Inspector General examines expenditures for compliance with predetermined criteria, including the efficiency of operations and compliance with rules and regulations. All audit reports are submitted to the BPK and the BPKP. The MoF's Inspector General has established an internal investigations unit to investigate allegations of misconduct and corruption by officials within its ranks. The government is keen to promote this as a means of increasing the integrity of its staff.⁹¹

In 2007, the BPK will begin to monitor and control the public accounting profession by setting a test that all public accountants must pass. Currently many public accountants are unprofessional and responsible for not uncovering state finance losses.⁹²

National Statistics Agency

The Indonesian National Statistics Office (BPS) is required by law to publish national accounts data as stated in the explanation of Article 5 of the Statistical Law. BPS is a non-departmental government institution directly responsible to the president. All statistics collected by the BPS are governed by the Statistical Law of Indonesia No. 16/1997, which established the statistical independence of the BPS. Under the law, the BPS has the freedom to determine methodologies, the forms of data collection, and the format and timing of publication of data. The BPS cannot publish, or otherwise make available to any individual or organisation, statistics that would enable the identification of data for any individual or entity. The BPS has statutory independence on technical matters, but does not review fiscal data or assess its quality. According to commentators, BPS staff exhibit a high degree of professionalism in their work.⁹³

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Indonesia between 6 and 10 November 2006:

Ministry of Finance

8 November 2006

Boediarso Teguh Widodo	Director	State Budget Planning
Agung Widiadi	Economist	State Budget Planning

Central Bank of Indonesia

7 November 2006

Suhaedi	Senior Economist	Monetary Policy Bureau
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Department of Taxation

9 November 2006

Erwin Silitonga	Director
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ADDITIONAL INTERVIEWS

6 November 2006

Anwar Nasution	Director	State Audit Agency (BPK)
I Gusti Agung Rai	Member	State Audit Agency (BPK)

9 November 2006

Stephen Schwartz	Senior Resident Representative	IMF
Ian Lienert	Senior Economist	IMF

10 November 2006

Rajiv Sondhi	Senior Financial Management Specialist	World Bank
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NOTES

¹ See the 1945 Constitution of the Republic of Indonesia (unofficial translation) at:

www.ilo.org/public/english/employment/gems/eeo/download/consi.pdf

² See www.dpd.go.id

³ *Indonesia: Report on Observance of Standards and Codes – Fiscal Transparency Module*, IMF, September 2006, page 13, point 17

⁴ Local governments in each province consist of several regencies (Kabupaten), which are divided into municipalities (Kota), which are further divided into districts (Kecamatan), which are in turn divided into villages.

⁵ *Indonesia: Investing for Growth and Recovery*, World Bank Report No. 35423-IND, June 9, 2006

⁶ Interviews in Indonesia, 14-17 November 2005.

⁷ *Indonesia: Report on Observance of Standards and Codes – Fiscal Transparency Module*, IMF, September 2006

⁸ *Indonesia Fourth Post-Program Monitoring Discussions*, IMF, Country Report No. 06/85, February 2006

⁹ Interviews in Indonesia, 4-6 October 2004.

¹⁰ Interviews in Indonesia, 14-17 November 2005. See also IMF, “Indonesia: 2004 Article IV Consultation and Post-Program Monitoring Discussions -- Staff Report; Staff Statement; and Public Information Notice on the Executive Board Discussion”.

¹¹ Interviews in Indonesia, 6-10 November 2006.

¹² *Indonesia: Report on Observance of Standards and Codes – Fiscal Transparency Module*, IMF, September 2006

¹³ Interviews in Indonesia, 14-17 November 2005. A 3% budget deficit ceiling (set by the State Finance Law) will be imposed on all regions; regions will be evaluated on credit-worthiness criteria and the debt held by regions will be rated; and, crucially, the MoF will not guarantee any regional borrowing.

¹⁴ *Indonesia: Selected Issues*, IMF, August 2006

¹⁵ “House passes bill on SOEs into law”, *The Jakarta Post*, 28 May 2003.

¹⁶ Interviews in Indonesia, 4-6 October 2004.

¹⁷ *Indonesia: Report on Observance of Standards and Codes – Fiscal Transparency Module*, IMF, September 2006

¹⁸ *Indonesia: Article IV Staff Consultation and Fifth Post-Program Monitoring Discussions*, IMF, Country Report No. 06/319, August 2006

¹⁹ Interviews in Indonesia, 4-6 October 2004.

²⁰ *Indonesia: Report on Observance of Standards and Codes – Fiscal Transparency Module*, IMF, September 2006

²¹ Interviews in Indonesia, 14-17 November 2005.

²² “Too High a Price”, Human Rights Watch, June 2006. This detailed report discusses the opacity of off-budget military finance in Indonesia.

²³ Interviews in Indonesia, 14-17 November 2005. The accountability of foundations is regulated by law, with the requirement to publish an annual report in local newspapers if the foundation has assets equal to or more than 20 billion Indonesian rupiah. However, since financial statements are rarely audited, in practice it is difficult to know which *yayasan* have assets above that threshold.

²⁴ See “Indonesia: 2005 Article IV Consultation and Third Post-Program Monitoring Discussions”, IMF Country Report No. 05/326, September 2005 at: www.imf.org/external/pubs/cat/longres.cfm?sk=18552.0.

²⁵ *Indonesia: Report on Observance of Standards and Codes – Fiscal Transparency Module*, IMF, September 2006

²⁶ Interviews in Indonesia, 6-10 November 2006.

²⁷ Interviews in Indonesia, 6-10 November 2006.

²⁸ Interviews in Indonesia, 6-10 November 2006.

²⁹ Interviews in Indonesia, 14-17 November 2005. See also *the Jakarta Post*, 10 December 2004 and:

www.ti.or.id/paper.htm

³⁰ Interviews in Indonesia, 6-10 November 2006.

³¹ “Darmin faces tough job reforming tax office”, Rendi Akhmad Witular, *Jakarta Post*, 1 May 2006

³² Interviews in Indonesia, 6-10 November 2006.

³³ Interviews in Indonesia, 6-10 November 2006.

³⁴ The report is not available in English.

³⁵ See www.djap.k.depkeu.go.id/APBN/Laporan%20Realisasi%20APBN%20Semester%20I%20TA%202005.pdf

³⁶ See for example Government Policy Programme reports at:

www.bi.go.id/web/en/info+penting/IRU/Policy%20Program

³⁷ Interviews in Indonesia, 6-10 November 2006.

³⁸ Interviews in Indonesia, 14-17 November 2005.

- ³⁹ “BPK slams accountants for poor handling of SOE audit”, *The Jakarta Post*, 1 November 2003.
- ⁴⁰ See www.depkeu.go.id
- ⁴¹ Interviews in Indonesia, 14-17 November 2005.
- ⁴² IMF Special Data Dissemination Standard (SDDS) - Indonesia, at <http://dsbb.imf.org/Applications/web/sddscountrycategorylist/?strcode=IDN>
- ⁴³ Interviews in Indonesia, 6-10 November 2006.
- ⁴⁴ The IMF gives each country the scope to take a limited number of flexibility options on timeliness and periodicity of prescribed data categories. In Indonesia, general government operations include those of the central government budget plus off-budgetary activities.
- ⁴⁵ Interviews in Indonesia, 6-10 November 2006.
- ⁴⁶ See Laporan Keuangan Pemerintah Pusat Tahun 2004 (in Bahasa Indonesia only) at: www.bakun.go.id/modul/donlot/ok.php?idk=438
- ⁴⁷ See www.bi.go.id
- ⁴⁸ See the National Medium Term Development Plan 2004-2009 (in Bahasa Indonesia only) at: www.bappenas.go.id/index.php?module=ContentExpress&func=display&ceid=1984
- ⁴⁹ See RKP Fiscal Year 2006 (in Bahasa Indonesia only) at: www.bappenas.go.id/index.php?module=ContentExpress&func=display&ceid=2480
- ⁵⁰ *Indonesia: Report on Observance of Standards and Codes – Fiscal Transparency Module*, IMF, September 2006
- ⁵¹ *Indonesia: Investing for Growth and Recovery*, World Bank Report No. 35423-IND, June 9, 2006 and Interviews in Indonesia, 6-10 November 2006.
- ⁵² Available at www.bi.go.id/ie/cat.asp?id=15
- ⁵³ “Indonesia: Selected Fiscal Issues in a New Era”, World Bank Report No.25437-IND, February 2003, p.57.
- ⁵⁴ Interviews in Indonesia, 19-21 November 2002.
- ⁵⁵ *Indonesia: Report on Observance of Standards and Codes – Fiscal Transparency Module*, IMF, September 2006
- ⁵⁶ Interviews in Indonesia, 6-10 November 2006.
- ⁵⁷ Interviews in Indonesia, 6-10 November 2006.
- ⁵⁸ Interviews in Indonesia, 6-10 November 2006.
- ⁵⁹ See www.bi.go.id/web/en/info+penting/IRU/Fiscal+sustainability/
- ⁶⁰ Interviews in Indonesia, 14-17 November 2005.
- ⁶¹ *Indonesia: Investing for Growth and Recovery*, World Bank Report No. 35423-IND, June 9, 2006
- ⁶² *Indonesia: Report on Observance of Standards and Codes – Fiscal Transparency Module*, IMF, September 2006
- ⁶³ “Indonesia: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding”, March 2003 available at www.imf.org/external/np/loi/2003/idn/01/index.htm and interviews in Indonesia, 4-6 October 2004.
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- ⁶⁹ Interviews in Indonesia, 6-10 November 2006.
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⁸² 'IMF Indonesia Report on the Observance of Standards and Codes Fiscal Transparency Module' September 26, 2006: Page 34, Point 70. See <http://www.imf.org/external/pubs/ft/scr/2006/cr06330.pdf>

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